

Improving the Investment Climate for the Mining Sector in Lao PDR

Background

The mining sector in Lao PDR has grown rapidly since 2000 when the country significantly widened its doors to private enterprise. Mineral resources with good prospects include gold, copper, tin, coal, potash, gypsum, and sapphire, and there is potential for mining other minerals as well. In the country's recent National Socio-Economic Development Plan, mining was named a key sector for private investment as it has the potential to boost economic and social development, and enable Lao PDR to graduate from least developed country status by 2020.

In 2000, mining accounted for 0.5% of GDP, and by 2006, the sector had grown to 5.5%. By 2010, the Government projects that mining will account for 10% of GDP, making it the largest industrial sector. The mining sector is important not only for its ability to generate significant revenue for the national treasury, but also for its potential to create jobs in remote mine site communities and surrounding areas. Currently, 112 foreign and domestic mining projects are under development in Lao PDR, in stages that range from exploration and feasibility studies, to extracting what is discovered. In order for the sector to achieve the Government's development objectives, the number and kinds of companies engaged in mining must increase, and existing companies must be able to expand their operations.

In addition to tremendous practical problems facing the mining sector in Lao PDR, including lack of access to resources such as large tracts of land, power, water, telecommunications, equipment, local and international experts and qualified workers, the mining sector is also held back from achieving its potential due to the regulatory regime. The Government recognizes the need to improve the legal and regulatory environment and is currently revising the 1997 Mining Law. The private sector, through the Lao Business Forum's Energy and Mining Working Group, has raised several issues that impact the sector and has become increasingly engaged in policy discussion through the public-private dialogue process.

With a more modern regulatory regime and the Government's greater understanding of what international mining companies require in order to invest, Lao PDR could position itself as a desirable country for the mining industry and provide the impetus for increased investment and important contributions to development.

Existing regulatory regime

The primary mechanism for obtaining investment and mining licenses has been negotiation of a comprehensive contract, based upon a model Mining, Exploration and Production Agreement (MEPA). This agreement was developed by the Committee for Planning and Investment (now the Ministry of Planning and Investment), in consultation with the Ministry of Energy and Mines (MEM). In recent years, the process has been broken into two parts, with companies first negotiating an exploration contract, and then, if a promising mineral resource is identified, negotiating a separate mining and production contract. This is an issue for mining companies, as it means that a company that invests in identifying a promising mineral resource is not guaranteed the first option to mine the resource.

Companies also have been required to obtain additional licenses and permits from a range of ministries in order to secure the resources required to explore and then develop a mining project. These numerous rounds of negotiation frustrate investors and discourage many from even starting exploration. The current regulatory regime essentially provides that different terms and conditions are negotiated for each and every mining project. Due to the low level of transparency, potential investors can find out little about what terms to expect for themselves.

In addition, the administrative burden of negotiating complex agreements on a project-by-project basis has seriously eroded the ability of MEM to administer and regulate the sector. One result has been a moratorium on gold exploration permits, which is the mineral of greatest interest to investors. This moratorium will continue until a new regulatory regime for mining is passed by the



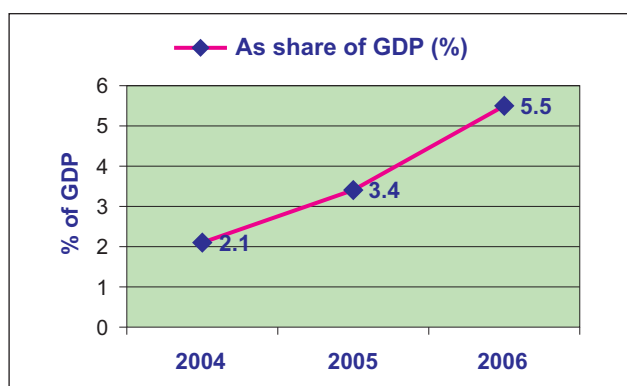
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The "Business Issues Bulletin" provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Lao PDR, and exposure to different opinions held by various stakeholders on the topic.

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Figure 1: Mining Sector as % of GDP



Source: Lao Authorities and World Bank staff estimates

National Assembly. The new Mining Law will govern all new licensing in the sector. Despite the good intentions of the moratorium, it seriously affects the growth of investment, and will reduce government revenues in the near to intermediate term.

Major regulatory issues

Significant steps have been taken by the Government to revise the Mining Law. A draft law has been prepared with the assistance of the World Bank and the International Finance Corporation, and significant consultation has taken place with the private sector and other stakeholders. In December 2007, MEM hosted a stakeholder meeting to discuss the draft Mining Law, how to attract high quality mining companies, and how to ensure that the draft Mining Law results in a more secure licensing and investment process and less administrative burden for the Government.

In the December stakeholder meeting, participants identified the following issues as paramount:

- Strengthening the security of tenure – the right to mine any resource found during exploration needs to be clearly articulated;
- Reducing the time Government takes to approve mining license applications;
- Enhancing the role that small domestic companies play in the mining sector;
- Setting application and surface rental fees which are appropriate for attracting exploration;
- Taxing mining at the same level provided by the general taxation regime;
- Defining clearly the requirements for land use fees, compensation and resettlement;
- Clearly determining the responsibilities that national and provincial authorities have with regard to mining project regulation;
- Ensuring exploration licenses provide for clear and reasonable environmental management and social development duties;
- Setting clear priorities concerning land use (for example, for agriculture, mining, and traditional land

Figure 2: Mining Exports (% of total exports)



Source: Lao Authorities and World Bank staff estimates

use);

- Strengthening intergovernmental coordination for all development projects;
- Carefully considering the kinds of regulations that are necessary at each stage of development from exploration to mining, and whether investor protection is required at all stages;
- Strengthening assurance for investors that the information they submit to Government will remain confidential; and
- Clarifying licensing procedures as well as provisions for transitioning existing licenses when the new Mining Law comes into effect.

Direction for reforms

The new Mining Law – currently in draft – reflects the Government's desire to move away from negotiating different contracts with each investor and provides a framework for a law-based regulatory regime for all but the largest projects. It also emphasizes attracting and keeping companies that will be able to adhere to the highest international technical, environmental and social standards. As such, the proposed law raises the bar for companies because they must demonstrate up front that they have the capability to meet the required standards. Companies will also have to submit a work plan that reflects planned investment, and this will be reviewed annually to ensure commitments are met. Such a licensing system responds to the Government's wish to eliminate unqualified companies which have entered the sector with the hope of selling their license or finding a joint venture partner with 'deep pockets'.

The new draft Mining Law proposes the following:

- Streamlined licensing for mining investments;
- Establishment of a Mining Registrar with a "front counter" for receiving applications, providing compliance information and disseminating information about the mining sector;
- Use of objective criteria in making decisions about whether or not to grant applications, and written justifications based on these criteria when applications are rejected;

- Establishment of an Inter-Ministerial and Provincial Cooperation Committee on Mining to avoid national and provincial authorities duplicating each others' efforts and to ensure that disputes are resolved when different national and provincial agencies disagree;
- Establishment of a Steering Committee on Large Mines that will serve as the governing body for projects of such size or importance that the company could propose a comprehensive agreement covering both exploration and mining rights as a single agreement;
- Establishment of an Artisanal Mining Committee to bolster small-scale mining development and deal with health, safety, environmental and underground/informal issues often prevalent in this segment;
- Development of model licensing agreements that minimize the number and scope of negotiable terms.

The draft Mining Law also sets out requirements for feasibility studies. A feasibility study must demonstrate that the company seeking to launch a mine has carried out the necessary technical, environmental and social assessments. Also, the company must demonstrate in its mining license application that its employees have sufficient technical, environmental and social development skills to develop and operate a mine, and that it has the necessary funding to underwrite and commence the project. If a company fulfills these requirements, the new draft Mining Law stipulates that a mining license must be granted. Other provisions require adequate planning for all the stages of a mine's life, including closure and rehabilitation of the natural environment.

Conclusion

The Government's decision to revise the Mining Law demonstrates its desire to raise the sector's importance and to attract high quality international and regional companies that follow sound international practice. While the current regulatory regime has resulted in a moratorium in the most active exploration commodity, there is a clear commitment to resolving issues that stand in the way of establishing a modern mining regulatory regime. Significantly, the Government recognizes that the views of the private sector and other relevant stakeholders are critical in developing a modern regulatory regime for the mining sector. This regime should provide the guidance necessary for both the Government's administrative and regulatory mechanisms, and for decision making that provides sufficient guarantees to investors that their investment is secure and administered rationally, in accord with international norms.

Government Viewpoint:

Many domestic and foreign investors are interested in mineral exploration, mining and processing in the Lao PDR. Commodity prices have increased dramatically as international demand has grown for mineral products. There are a total of 112 companies operating in the sector at various stages for 22 types of minerals in 16 provinces

and the capital city. Importantly, these mining sector activities have provided revenue for the government and generated jobs for people living in the surrounding areas. These activities contribute to the overall socio-economic development of the country. The increasing importance of the mining sector to the development of the Lao economy has prompted the government to pay special attention to the revision of the 1997 Mining Law and the existing legal framework of negotiation of MEPA exploration and production contracts.

As part of the process of revising the legal framework, the government has welcomed input from a wide variety of sources, including the private sector, diplomatic community, international organizations, representatives from government agencies, local authorities and international experts. These inputs have identified many complex issues that require further consideration and deliberation by the Government. We anticipate that further dialogue will be needed during the drafting process to strengthen the understanding and appreciation of the complex issues involved in mining. This consultation process is critical to achieving an international-standard legal framework for mining that will allow Lao PDR to be the destination of choice for large, high-quality exploration and mining companies, which in turn will allow the country to realize the development benefits that a robust mining sector can provide.

H.E. Somboun Rasasombath, Vice-Minister, Ministry of Energy and Mines

Industry Viewpoint:

A sound and stable mining investment regime is critical for the industry. Companies face hardships and increased risk when seeking to undertake exploration and mining in Lao PDR from factors that include a lack of infrastructure, large amounts of unexploded ordinance in some areas and changing and evolving laws. Also, mining is inherently exceptionally high risk and although many exploration projects are started, these projects must often be abandoned because resources are not found in large enough quantity to make them worth developing. Because of the high risks and costs associated with bringing remote mineral resource projects to production, companies must carefully screen where they do business and seek to operate in countries that can guarantee a stable, long term environment for its operations. Because the risks are so high, it is even more important that the government provides the transparent regulatory environment that many international companies require prior to investment. Since there has been uncertainty regarding the application of the 1997 Mining Law, the government's decision to revise this law is a welcome step for companies seeking to evaluate the investment climate in the Lao PDR mining sector.

When evaluating a country's investment potential, a company looks for a legal framework that includes:

- Security of tenure – Can the investment be taken away or stalled for reasons beyond the company's control? What guarantees are in the law that ensures

this won't happen? What processes does the country have to make sure that the investment is not unfairly lost to someone else? Does the government have a history of arbitrarily imposing terms on companies that impact project economics?

- Stable fiscal system – Is there a fiscal system in place that can be predicted for the entire length of the life of a mining project to determine whether a project is economic should the company find a deposit?
- Size of area – Are sufficient areas offered for exploration that will allow for fair reconnaissance, prospecting and exploration? Will adequate access to areas for mine related activities be granted?
- Environmental and social obligations – Are the environmental and social development commitments adequately described so a project's economic viability can be ascertained up front? Or will the obligations change over time affecting whether the project continues to be profitable?
- Government understanding of the mining industry – Does the government understand international economics and project economics sufficiently such that it will not impose requirements that will jeopardize the project's viability or level of profitability? Can the government guarantee that all the resources necessary to develop a project are available?

The industry welcomes the government's decision to revise its Mining Law and appreciates the opportunity to provide input into the drafting process through the stakeholder meetings organized so far by the Ministry of Energy and Mines.

Robert Allen, General Manager, Country Affairs, Phu Bia Mining Co.

International Mining Viewpoint:

Today, international mining companies have a choice of countries in which to invest high-risk exploration and mining dollars. Companies evaluate many factors, not just geologic potential, to determine whether one country versus another will provide a more stable and favorable climate for a profitable mining project that can last up to 50 years. In searching for a country in which to invest, one of the most important criteria is the legal regime under which a company will operate. History has shown many times that countries with modern, competitive, transparent, and open-market mining regulatory regimes will attract high-quality international companies. Unfortunately, many countries, especially transitional markets, that are just opening their sectors to international investors, often do not understand that a solid legal framework is required, which allows investors to easily ascertain obligations (fiscal, environmental, social and others) over the entire life of a potential project. This knowledge will strongly influence a company's decision whether or not to invest. International

companies are willing to pay taxes and royalties, and provide for enhanced environmental protection and increased commitments to social development as long as the investment climate provides them with long-term stability and gives them the ability to determine project economics based upon the international markets.

A country's determination to make mining a pillar of its industrial economy and to realize the development benefits that mining can offer (while safeguarding the environment and communities) must be followed by integrating sound international norms into its legal regime. Lao PDR has taken the first and most important step towards becoming a favorable destination for exploration and mining investment by recognizing that its legal regime needs to be revised. An international standard Mining Law has been drafted with the assistance of the World Bank and IFC and the government is committed to a thorough consultation process with key stakeholders, in particular the private sector. These steps are very encouraging and provide the basis for optimism that the Lao PDR mining sector, if it continues along this path, will be able to contribute to the government's goal of graduating from the status of least developed countries by 2020.

Craig Andrews, Senior Mining Advisor, World Bank

International Law Viewpoint:

Lao PDR is at an exciting and challenging crossroads in its mining sector. With the government's decision to revise its 1997 Mining Law and create a comprehensive statutory regulatory regime, it is possible to obtain significant advantage for the country by attracting additional investment into the sector. The government can create this advantage by developing a "win-win" regulatory regime that serves two purposes: 1) ensuring that the country will realize the significant benefits of investment from mining activities in order to achieve solid economic and social development; and 2) providing the international mining industry with a stable, transparent environment in which to work. Understanding that both goals are part of a successful reform process will be vital for formulating and enforcing new legislation.

Change in any regulatory regime can be difficult especially in a transitional economy, which is taking steps toward market economy reforms in the hope of attracting greater international investment. In Lao PDR preliminary signs of success are already evident. The government has opened its drafting process to include the views from international organizations, the private sector and other stakeholders to better understand the myriad of issues it needs to address. The government's efforts to date, its commitment to reform, and its resolve to improve the socio-economic development of the country through investment in sectors like mining should be highly commended.

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